EXECUTIVE SECRETARIAT

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Remarks

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Executive Secretary

27 Feb 85

Date

3637 (10-81)

OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

EP

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February 26, 1985

~~UNCLASSIFIED~~
~~(With Confidential Attachment)~~

MEMORANDUM FOR THE VICE PRESIDENT
THE SECRETARY OF STATE
THE SECRETARY OF DEFENSE
THE SECRETARY OF AGRICULTURE
THE SECRETARY OF COMMERCE
THE SECRETARY OF TRANSPORTATION
THE SECRETARY OF ENERGY
DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
DIRECTOR OF CENTRAL INTELLIGENCE
UNITED STATES TRADE REPRESENTATIVE
ASSISTANT TO THE PRESIDENT FOR NATIONAL SECURITY AFFAIRS
ASSISTANT TO THE PRESIDENT FOR POLICY DEVELOPMENT
CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS
DEPUTY SECRETARY OF THE TREASURY

SUBJECT: Senior Interdepartmental Group on International Economic Policy (SIG-IEP)

Attached are discussion papers for the SIG-IEP meeting scheduled to be held on Thursday, February 28, 3:00 p.m. in the Roosevelt Room.

Edward J. Stucky
Edward J. Stucky
Acting Executive Secretariat

cc: Staff Secretary and Deputy Assistant to the President
Deputy Assistant to the President for Cabinet Affairs

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~~(With Confidential Attachment)~~

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Options on Japanese Automobile VRA

Introduction

The CCCT/TPC agreed to let the voluntary restraint agreement (VRA) on Japanese automobiles lapse. It recognized that, without the VRA, U.S. automobile producers are likely to have more trouble meeting the U.S. Corporate Average Fuel Economy (CAFE) standard. (The standard requires U.S. producers to sell a fleet of cars with an average mileage above 26 miles per gallon or face stiff fines.) The standard, however, does not provide sufficient reason to extend the VRA. Discussion of the CAFE issue will continue in the CCCT.

Issue

The key outstanding issue for discussion by the SIG-IEP is the method by which the VRA is allowed to lapse. The four major options are discussed below. The manner in which the VRA is terminated concerns the SIG-IEP because it bears -- or could bear -- a relationship to the market-opening (MOSS) negotiations now intensively underway.

Options

1. No formal decision: The VRA would be allowed to lapse without a formal Presidential decision or announcement.

2. A Rollback in Protectionism: An immediate decision and announcement to end the VRA would be made. The decision would be billed internationally (at the Bonn Economic Summit and in the OECD and the GATT) as a unilateral U.S. effort to reduce protectionism. It would be used to encourage other countries to follow suit as a first step toward a new GATT round to liberalize international trade.

3. Anti-Surge Mechanism: The Administration would inform Japan that we decided to allow the VRA to lapse. We would, however, ask Japan to prevent a surge in U.S. imports of Japanese automobiles.

4. Leverage for Japanese liberalization: The Administration would announce that it is allowing the VRA to lapse. It would tell Japan that this action is a good will measure by the United States, but warn it that (a) a surge in Japanese automobile exports to the United States would inflame protectionist pressures here and (b) by April 1 the USG expects to see significant progress in the telecommunications negotiations. Specifically, the forthcoming ordinances should reflect U.S. views and ensure us equitable access to Japan's telecommunications market.

SUDAN

Purpose of Meeting

In late 1984, there was interagency agreement on a strategy under which Economic Support Funds (ESF) to Sudan for both FY 84 and FY 85 would be held back until that country adopts a comprehensive stabilization program supported by the IMF. In light of Vice President Bush's planned trip to Sudan on March 4 and the scheduled Washington visit of President Nimeiri in late March, the issue is whether we should now release some resources, in exchange for Sudanese implementation of a package of policy measures which is expected to fall well short of a comprehensive economic adjustment program. The SIG-IEP is being asked to review the situation and to determine whether to maintain the existing strategy and have the Vice President reinforce it with Nimeiri during his upcoming trip. Treasury strongly believes that we should stay the present course.

Background

Sudan's economic problems stem from economic mismanagement, compounded by unwise and excessive borrowing in the 70s and by the unfavorable global economic environment of the early 80s. Real GNP growth was less than population growth between 1978 and 1982. Since then it has been negative, including a projected fall of 3-4 percent in 1984/85. Fiscal deficits have been large and Sudan's total debt of over $9 billion exceeds its GNP. The current account deficit has remained unsustainably high, and will substantially worsen in 1985 in the absence of a comprehensive stabilization program.

Sudan has sought IMF support every year since 1978, and obtained debt relief in 1979 and every year since 1982. This IMF support was provided at the encouragement of the U.S., and has led to a situation where Sudan has substantial arrears to the IMF, and its access to additional IMF financing is severely limited. Despite this extraordinary assistance, Sudan's economic situation now is worse than ever. Nimeiri's unwillingness to apply consistently needed economic discipline has resulted in Sudan's missing adjustment targets in Fund programs on numerous occasions, and IMF agreements frequently becoming inoperative. Also, it has been necessary to hold three IBRD-led special aid pledging exercises between 1980 and 1983 to get donors to provide more aid to cover the foreign exchange needs resulting from his failures and patch together IMF programs.

Last December, Secretary Shultz sent a letter to President Nimieri advising him that further release of U.S. ESF assistance would be conditioned on Sudan reaching agreement on a comprehensive stabilization program that could command the support of the international creditor community, including the IMF. In order to carry out this strategy, the Fund agreed to hold consultations with Sudan under the rubric of "technical discussions" since its rules proscribe negotiations with a country in arrears to the Fund until all payment obligations to it are current.

This strategy has been supported by the G-5 countries and the Saudis. Full support for this approach was reconfirmed by the G-5 Debt Deputies at their meeting in Paris last week. Except for humanitarian assistance, for on-going projects and, in one case, for agricultural recovery, the G-5 have cut off aid to Sudan. The G-5 were unanimous in the belief that new aid should remain on hold until an IMF program is adopted.

There have been two recent exceptions to this aid cut-off. One was Saudi Arabian disbursement of $35 million worth of petroleum to meet a severe shortage of gasoline. The other was the USG released $5 million for the purchase of a hybrid fast-growing seed which had to be planted in February.

In late January a Fund mission went to Khartoum and negotiated preliminary agreement with the Finance Minister and other senior officials on a package of measures which could have formed the basis for a Fund program. It included a devaluation, a reduction in the budget deficit and a contribution to the financing of the petroleum facility which would permit Sudan to import oil more cheaply. However, President Nimieri rejected the package as politically unacceptable.

Meanwhile, the Sudan's financial outlook is deteriorating. The external unfinanced gap for 1985, assuming a Fund program were put in place, was originally estimated at $280 million but is now projected at $400-500 million. Therefore, even if Nimeiri were to agree to a Fund program, Sudan's official donors would need to provide an additional $400-500 million for the agreed IMF program to work (there is little commercial bank lending to Sudan), as well as to enable Sudan to pay its arrears to the IMF.

Sudan's arrearage problem with the Fund is rapidly approaching a crisis point and could pose a serious threat to the financial health of the IMF itself. Sudan's arrears, presently exceeding $100 million, are the largest of any member, are more than half of total IMF arrears and are more than double the Fund's projected FY 1985 income. If Sudan's arrears continue to grow they will total about $250 million by end-1985 and $440 million by end-1986. The U.S., as the largest IMF creditor, has been the leading advocate of a "get-tough" policy on IMF arrears, including a prohibition on new IMF financing until all arrears are eliminated. Eventually, we could face the prospect of having a close ally of the U.S. being considered for expulsion from the IMF.

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The SIG-IEP is being asked to consider releasing the remaining FY 84 ESF money (approximately $80 million) in exchange for implementation of a package of measures which Nimieri reportedly supports. The Sudanese Finance Minister and the Central Bank Governor will be in Washington February 27 - March 1 to discuss the Sudanese package with us and the IMF. It is expected that the combination of measures -- which include the recent devaluation, movement toward implementation of the petroleum facility, petroleum price increases, and fiscal measures -- will fall well short of what the Fund staff had negotiated in Khartoum early in February.

Recommendation

Treasury strongly supports continuing our present strategy. To disburse FY 84 and FY 85 ESF money in the absence of a comprehensive adjustment program supported by the IMF would:

(a) increase the already sizeable ($400-500 million) financial gap which official donors would be required to fill;

(b) place the US in the position of being the only major donor disbursing funds and by doing so compromise our credibility with the other donors, the IMF, other LDC debtors, as well as Sudan;

(c) undermine the IMF in a specific country situation involving not only the necessity of a Fund program, but also the crucial question of Fund arrearages; and,

(d) move Sudan away from the IMF, leading to additional build-up of arrears which would soon confront the US with a choice between the IMF's financial health and expulsion of an important US ally from the IMF.

EK

EXECUTIVE SECRETARIAT
ROUTING SLIP

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SUSPENSE ______________
Date

Remarks

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STAT

Executive Secretary

26 Feb 85

Date

3637 (10-81)

Executive Registry

85- 871

THE SECRETARY OF THE TREASURY

WASHINGTON, D.C. 20220

February 25, 1985

UNCLASSIFIED

MEMORANDUM FOR THE VICE PRESIDENT
THE SECRETARY OF STATE
THE SECRETARY OF DEFENSE
THE SECRETARY OF AGRICULTURE
THE SECRETARY OF COMMERCE
THE SECRETARY OF TRANSPORTATION
THE SECRETARY OF ENERGY
DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
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CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS
DEPUTY SECRETARY OF THE TREASURY

SUBJECT: Senior Interdepartmental Group on International Economic Policy (SIG-IEP)

A meeting of the SIG-IEP is scheduled to be held on Thursday, February 28, at 3:00 p.m. in the Roosevelt Room. The agenda items are:

1. Implications of Voluntary Restraint Agreement Decision for MOSS Negotiations; and

2. Sudan

Discussion papers for each agenda item will be circulated at a later date. Attendance will be principal plus one.

James A. Baker III

James A. Baker, III

cc: Staff Secretary and Deputy Assistant to the President
Deputy Assistant to the President for Cabinet Affairs

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